

# State of Nevada Department of Business & Industry



*Industrial Development Bond Seminar*

# Tax-Exempt Bonds

## Presenters

**Ryan  
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LLP

# Types of Bonds that can be issued

## **Taxable vs. Tax-exempt**

- Tax-exempt is where interest on bonds is exempt from federal income tax for the owners of the bonds. Benefit is a lower cost of borrowing for the borrower.

# Types of Bonds that can be issued

The types of taxable bonds that can be done is governed by State law. State law permits projects for industrial uses, warehousing, research and development, civic and cultural enterprises, educational facilities, health care facilities, renewable energy or any commercial enterprise.

# Types of Bonds that can be issued

The types of bonds that can be done on a tax-exempt basis is limited by federal law.

- “Qualified Bonds”
  - Exempt Facility Bonds

# Types of Bonds that can be issued

- Airports

- The Internal Revenue Code (the “Code”) defines the term “airport” to include facilities that:
  - are directly related and essential to (a) servicing aircraft, enabling it to take off and land (such as a maintenance or overhaul facility), or (b) transferring passengers or cargo to or from aircraft, and
  - need to be located at or in close proximity to the runway area in order to perform their function
- The Code provides that a hangar or repair facility at a municipal airport will meet the public use requirement, even if leased to a nonexempt person, if the nonexempt person directly serves the general public as a common carrier or if it is part of a facility available for public use.

- Mass commuting facilities

# Types of Bonds that can be issued

## Facilities for the furnishing of water

- Section 142(e) provides that a facility for the furnishing of water (e.g., water treatment and distribution facilities) for any purpose will qualify as an exempt facility if:
  - the water is or will be made available to members of the general public (including electric utility, industrial, agricultural, or commercial users with an additional requirement that at least 25% be residential users); and
  - either the facilities are operated by a governmental unit or the rates for the furnishing or sale of the water have been established or approved by a State or political subdivision thereof, by an agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof.

# Types of Bonds that can be issued

## **Sewage facilities**

- Dating from the early 1970's, the Code defined "sewage disposal facility" to mean any property used for the collection, storage, treatment, utilization, processing or final disposal of sewage. A later regulation, promulgated in December of 1994, provides a more detailed definition. New definition indirectly defines sewage as wastewater requiring traditional secondary (biological) treatment and having a biochemical oxygen demand (BOD) of 350 mg/liter. Definition specifically excludes "pretreatment facilities" designed to deal with contaminants other than BOD, pH, oil and grease, fecal coliform and TSS total suspended solids. Costs of dual function (i.e., qualifying and nonqualifying) facilities must be allocated on a reasonable basis.



# Types of Bonds that can be issued

## **Solid waste disposal facilities**

- A more detailed discussion will follow.

# Types of Bonds that can be issued

## **Qualified residential rental projects**

- A “residential rental project” is a building or structure containing one or more similarly constructed units that are not used on a transient basis.
- A unit must contain separate and complete facilities for living, sleeping, eating, cooking and sanitation, but may, however, be served by centrally located equipment such as air conditioning or heating.
- Hotels, motels, dormitories, fraternity and sorority houses, rooming houses, hospitals, nursing homes, sanitariums, and rest homes are not residential rental projects.

# Types of Bonds that can be issued

## **Facilities for the local furnishing of electric energy or gas**

- The Code permits the tax-exempt financing for the local furnishing of electrical energy or gas. “Local furnishing” includes two contiguous counties as well as a city and a contiguous county. Either the owner or operator of the facilities must be obligated by law, ordinance or regulation to furnish gas or electric energy to all persons within the service area who request it and it must be reasonably expected that the facility will serve or be available to serve a large segment of the general public in the service area.

# Types of Bonds that can be issued

## **Local district heating or cooling facilities**

- A local district heating or cooling facility for two contiguous counties or one city and a contiguous county qualifies as an exempt facility under the Code. Such facilities must be part of a system consisting of a pipeline or network providing hot or chilled water or steam to 2 or more users for (a) residential, commercial or industrial heating or cooling or (b) process steam.

# Types of Bonds that can be issued

## Qualified Hazardous Waste Facilities

- Qualified hazardous waste facilities under the Code are facilities which provide for the disposal of hazardous waste by incineration or entombment only if the facility is subject to final permit requirements under subtitle C of title II of the Solid Waste Disposal Act (RCRA) as in effect on October 22, 1986.
- Cannot finance portion of the facility allocable to the processing of hazardous waste generated by the owner or operator of the facility or related person to such owner or operator (i.e., the facility is required to be available for use by the “public”).
- “Hazardous waste” does not include radioactive waste and must be material having no market or other value at the place it is located.

# Types of Bonds that can be issued

## High speed intercity rail facilities

- A facility qualifies as a high-speed intercity rail facility if it is a facility (other than rolling stock) for fixed guideway rail transportation of passengers and their baggage between metropolitan statistical areas (as such areas are defined by the Secretary of Commerce). The facilities must use vehicles that are reasonably expected to operate at speeds in excess of 150 miles per hour between scheduled stops and the facilities must be made available to members of the general public as passengers.
- The facility does not have to be owned by a governmental unit; however, any non-governmental owner must elect irrevocably not to claim any deduction for depreciation under the Code or claim any income tax credit with respect to the property to be financed with the issue's net proceeds.
- The Code, which limits the use of bond proceeds to acquire land to 25%, does not apply to land acquired for noise abatement, wetland preservation or future use as a high-speed rail facility if there is no other significant use of such land. With regard to the public approval requirement, if the issuer of the bonds is also the owner or operator of the facilities it is deemed to be the only governmental unit having jurisdiction over such facility for purposes of the requirement.

# Types of Bonds that can be issued

## **Environmental enhancements of hydroelectric generating facilities**

- The Code applies to facilities where at least 80% of the proceeds of the bonds are used to finance property for a federally licensed hydroelectric generating facility and which either protects or promotes fisheries or other wildlife resources or is a recreational facility or other improvement required by the federal licensing permit for the operation of the generating facility. The category is seldom if ever used.

# Types of Bonds that can be issued

## **Qualified public educational facilities**

- The Code applies to bonds at least 95 percent of the net proceeds of which are used to provide school facilities owned by for-profit entities pursuant to public-private partnership agreements with a State or local educational agency. The school facilities must be operated as part of a system of public schools. School facilities include school buildings and functionally related and subordinate land and can include stadiums or other athletic facilities used primarily for school events. These bonds are not subject to the general volume limitation under the Code but are subject to a separate volume limitation.



# Types of Bonds that can be issued

## **Qualified highway or surface freight transfer facilities**

- Up to \$15 billion dollars of bonds for qualified highway or surface freight transfer facilities may be issued. It applies to bonds at least 95 percent of the net proceeds of which are spent to provide qualified highway or surface freight transfer facilities within 5 years. The Secretary of the Treasury may extend the 5 years upon request.
- Qualified highway or surface freight transfer facilities are:
  - (1) any surface transportation project that received federal highway funds
  - (2) any project for an international bridge or tunnel for which an international entity is responsible and received federal funds, or
  - (3) any facility for the transfer of freight from truck to rail or rail to truck.

# Tax-Exempt Bonds

**Federal tax law requirements and limitations on three categories of these bonds:**

- Small Issue Industrial Development Bonds (SIDBs)
- Qualified 501(c)(3) Bonds (501(c)(3) Bonds)
- Solid Waste Disposal Facility Revenue Bonds (SWDBs)

# Small Issue Industrial Development Bonds (SIDBs)

## In General

- Financing is only available for new investment of land, buildings, or manufacturing equipment. No refinancing.
- Termed “small issue” due to IRS Code limitation of principle amount of issue to either \$1M or \$10M.

# SIDBs

## State Law Provisions

Pursuant to N.R.S. 349.510(1), SIDBs can be used to finance certain projects, including any land, building, or other improvement for “industrial uses, including assembling, fabricating, manufacturing, processing or warehousing” and “commercial enterprises.”

# SIDBs

## Federal Law Requirements – In General

### Exempt small issue qualifications

- 95% of the bond issue proceeds must be used to:
  - acquire
  - improve
  - construct, or reconstruct land or depreciable property (includes buildings, fixtures, machinery, & equipment)
- 5% of bond proceeds can provide working capital
  - Under NRS, working capital costs not financeable

# SIDBs

## Federal Law Requirements: Manufacturing Facilities

- Only “**manufacturing facilities**” may be acquired.
  - Facilities must relate to some type of fabrication or processing of goods.
- Ancillary facilities must be directly related to manufacturing operation function.
  - Limited to a maximum of 25% of the costs used to build or acquire the “core manufacturing” facilities.
- Corporate headquarters offices.
  - Subject to the 25% limit noted above.
  - Will not qualify to the extent they exceed what is needed to supervise the particular manufacturing facility being financed.
  - Tax counsel reviews architectural plans to ascertain the usage of all parts of a manufacturing building.

## SIDBs

# Federal Law Requirements – Size Limitations

Section 144(a)(4) of the Code limits the size of an exempt small issue to \$1 million, or, upon the making of an election by the Issuer, \$10 million.

## SIDBs Federal Law Requirements – Size Limitations \$1 Million Limit

- Bonds issue cannot exceed \$1 million. To calculate this amount, it is necessary to combine (i) the face amount of the bonds to be issued and (ii) the remaining outstanding principal amount of any prior exempt small issue bonds previously issued to finance facilities within the same political jurisdiction for the borrower or any of its “related persons.”
- This provision essentially makes available at least \$1 million in tax-exempt bonds to finance industrial facilities for any borrower in each city or county where the borrower has ongoing or new capital requirements subject to the \$40 million limit (discussed below).



## SIDBs

# Federal Law Requirements – Size Limitations \$10 Million Limit

- If a proper election is made, issue amount of bonds can be \$10 million. \$10 million limit applies to the sum of (i) the face amount of the bonds to be issued, and (ii) the remaining principal amount of all prior small issue bonds previously issued to finance facilities within the same political jurisdiction for the borrower or any of its “related persons.”
- In addition, limit of \$20 million on *all capital expenditures* (A) made by the borrower or any “related person” for any facilities located within the jurisdiction; (B) made by any other “principal user” of the facility being financed (such as a landlord or tenant); or (C) made by any person (whether or not a “principal user”) to benefit the bond-financed facility.

## SIDBs

# Federal Law Requirements – Size Limitations \$10 Million Limit (cont.)

- Capital expenditures measured over a six-year period (the "Test Period") which begins three years before the bonds to be qualified are issued and ends three years after the date of issuance.

## SIDBs

# Federal Law Requirements – Other Limitations

- No more than 25% of the proceeds may be used for automobile sales or service, retail food or beverage facilities (which does not include grocery stores), or provision of recreation or entertainment.
- No proceeds may be used for commercial golf course, country club, massage parlor, tennis club, skating facility, racquet sports facility, hot tub or suntan facility, racetrack, airplane, sky box, health club, gambling facility or retail liquor store.
- Not more than 25% of net bond proceeds can be used to pay for land costs.

## SIDBs

### Federal Law Requirements – Other Limitations (cont)

- Only new facilities can be financed with one exception -- a used building (and its existing equipment) can be acquired if the borrower spends an amount equal to at least 15% of the amount of bond proceeds to be used to acquire the facility on rehabilitation expenditures within two years.
- No company can use or benefit from either a \$1 million or \$10 million SIDB if upon issuance the company's total outstanding SIDBs of all kinds will exceed \$40 million nationwide.
- SIDBs require allocations of volume cap

# Qualified 501(c)(3) Bonds –General–

- In order to be eligible to borrow using tax-exempt bonds, a nonprofit corporation must be a so-called “501(c)(3) corporation,” meaning a nonprofit corporation that has received a determination letter from the Internal Revenue Service that it qualifies as an organization of the type described in Section 501(c)(3) of the Code. Purposes are fairly broadly defined in the Code.
- Examples of 501(c)(3) corporations can include Private Nonprofit Educational Organizations (such as charter schools and colleges and universities), Cultural Organizations (such as museums, libraries and aquariums), Charitable Organizations (such as charities and foundations), Health Care Organizations (such as hospitals and clinics), Multifamily Rental Housing developers and other corporations that can else that can help to “lessen the burden of government.”

# Qualified 501(c)(3) Bonds

## State Law provisions

- Pursuant to N.R.S. 349.510(1), projects can include any land, building, or other improvement for “[t]he purposes of a corporation for public benefit,” which is defined to include a corporation that is “[r]ecognized as exempt pursuant to section 501(c)(3) of the Internal Revenue Code of 1986, ...future amendments to that section and the corresponding provisions of future internal revenue laws...”
- As a result, just about any 501(c)(3) corporation is eligible for 501(c)(3) Bond financing under Nevada law.

# Qualified 501(c)(3) Bonds Federal Tax Law Requirements

- 501(c)(3) Bonds primary use is for the acquisition or construction of a capital project – land, buildings, equipment and/or related infrastructure.
- Projects must be owned by the nonprofit corporation (or by a governmental entity) and not be used (i) in a manner that constitutes an unrelated trade or business under Section 513(a) of the Internal Revenue Code (which generally means that it be used in a manner consistent with the nonprofit purpose of the corporation) or (ii) in the trade or business of another person or entity (other than another 501(c)(3) corporation or governmental entity) (a “non-exempt person”).

# Qualified 501(c)(3) Bonds

## Federal Tax Law Requirements (cont.)

- “Use” of a project includes a leasehold interest, management or operation of project, contract to acquire output of a project, a research agreement that impacts bond-financed space, and any other similar use that conveys special legal entitlement for beneficial use of bond-financed space.
- Project or portions of it can be used by non-exempt persons in their trade or business if:
  - a. allocated bad use to sources other than proceeds of tax-exempt bonds (such as borrower equity or taxable debt)
  - b. bad use is less than 5% of proceeds of the bonds (net of reserves), with any proceeds used to pay costs of issuance of the bonds counted against this 5%
  - c. use by a non-exempt person is pursuant to an operating or management contract that meets the requirements of IRS Revenue Procedure 97-13 relating to term



# Qualified 501(c)(3) Bonds

## Federal Tax Law Requirements (cont.)

- Generally a borrower is limited to no more than \$150,000,000 of tax-exempt bonds being issued on behalf of itself and all parties related to the borrower.
- Broad exception -- does not apply to any bond issue if more than 95% of the bond proceeds are used to finance capital expenditures made after August of 1997.

# Solid Waste Disposal Facility Revenue Bonds ("SWDBs") General

SWDBs may be applied to finance not only traditional municipal solid waste-related capital expenditures (such as landfill costs, rolling stock, MRFs and equipment), but also potentially other categories of facilities such as:

- Waste-to-energy (burn) facilities
- Wood pellets production
- Synthetic fuel production

# SWDBs

## State Law Requirements

Pursuant to N.R.S. 349.510(1), these include any land, building, or other improvement for “industrial uses, including, fabricating, manufacturing, assembling, processing or warehousing” and “commercial enterprises.”

# SWDBs

## Federal Law Requirements – General

95% of the proceeds of the bond issue must be used to acquire, improve, construct, or reconstruct land or depreciable property for “solid waste disposal facilities.” This generally includes buildings, fixtures, machinery, and equipment.

# SWDBs

## Federal Law Requirements

### What is “Solid Waste”?

- Since October 2011, the so-called “no value” test is no longer necessary.
- “Solid waste” is garbage, refuse and other solid material derived from any agricultural, commercial, consumer, governmental or industrial operation, and must be either “used material” or “residual material.”
- Used material is material that has already been used for the purpose for which it was produced (e.g., the newsprint on which a newspaper has been printed). Residual material is material that has not been used but is residual material from a production process (e.g., the sawdust produced from a sawmill operation).
- Residual material must have a FMV that is reasonably expected to be lower than the value of all the products made in the production process or lower than the value of the service that produces the residual material.

# SWDBs

## Federal Law Requirements

### What is “Solid Waste”? (cont.)

- “Solid waste” does not include “virgin material,” dissolved solids in a liquid, certain precious metals, hazardous material (which can be financed under a separate “exempt facility” rule), and radioactive material.
- The determination of what specific materials qualify as solid waste is made as of the date bonds are issued. Thus, changes in markets or uses of materials after bonds are issued will not change the tax qualification of the project.

# SWDBs

## Federal Law Requirements (cont.)

### **What is a “Solid Waste Disposal Facility”?**

- A facility that: (i) processes solid waste in a “qualified solid waste disposal process,” (ii) performs a “preliminary function,” or (iii) is a “functionally related and subordinate facility.”

### **What is a “Solid Waste Disposal Process”?**

- A method that is: (i) a “final disposal process” (such as a landfill); (ii) an “energy conversion process,” (such as a waste-to-energy plant); or (iii) a “recycling process.”
- As with existing regulations, an energy conversion or recycling process ends when a useful, saleable product is created; this means, for example, energy turbines and pipelines in a waste-to-energy facility cannot generally be financed on a tax-exempt basis

# SWDBs

## Federal Law Requirements

### Dual and Mixed Use Facilities

- Cost can be allocated between the portion of dual use or mixed use facilities (such as a waste-to-energy plant which burns solid waste and also produces electricity) or facilities which process both solid waste and other material (such as a paper making facility which uses both waste paper and virgin fiber) which can be financed with tax-exempt SWDBs and other sources of funds.
- For a recycling facility with mixed inputs, so long as at least 65% by weight or volume of the material going into the facility qualifies as solid waste, the whole facility can be financed with SWDBs.



# SWDBs

## Other Federal Law Requirements

- No proceeds may be used for a commercial golf course, country club, massage parlor, tennis club, skating facility, racquet sports facility, hot tub or suntan facility, racetrack, airplane, sky box, health club, gambling facility or retail liquor store.
- Not more than 25% of net bond proceeds can be used to pay for land costs.
- Same rule as IDBs for used building and equipment.
- Volume cap allocation is required.

# General Tax Rules

## Federal Law Requirements

### Reimbursement Rules

- Reimbursements allowed for all project costs paid or incurred after a date, which is 60 days prior to the date of the inducement resolution (the “inducement date”) but prior to bond issuance (together, of course, with all costs to be paid after bond issuance).
- Certain “preliminary costs”, such as design, engineering, permitting, soil sample, etc., can be financed or refinanced from bond proceeds regardless of when they were first paid, provided such preliminary costs cannot exceed 20% of the bond issue (land acquisition, any site preparation or construction cannot count as a “preliminary cost”).
- Reimbursements of “hard costs” made after the inducement date (i.e., other than preliminary costs) must occur not later than the earlier of (i) 18 months after the project has been placed in service or abandoned, or (ii) 3 years after the expenditure has been made

# General Tax Rules

## Federal Law Requirements

### Other Rules

- No direct or indirect “federal guarantee” of a bond issue.
- Weighted average life of the bond issue cannot exceed 120% of the weighted average estimated useful life of the assets being financed.
- There must be a noticed public hearing, an elected official or elected body responsible for the bond issue with jurisdiction over the project site and must give its approval. This process is commonly referred to as the “TEFRA hearing.” In Nevada, the Director's Office holds the hearing (usually in Las Vegas or Carson City), and the approval is given by the Governor, prior to issuance of the bonds.
- Costs of issuance of the bonds paid from bond proceeds cannot exceed 2% of the face amount (i.e., sale proceeds) of the issue.

# Bond Issuing Procedure

## Presenter



**Richard Jost**

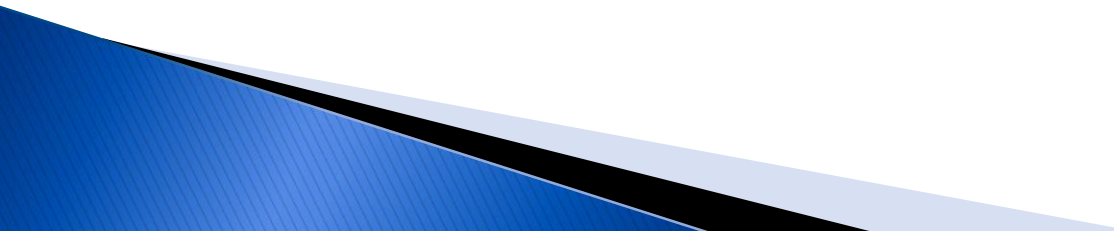
Director

Fennemore  
Craig Jones  
Vargas

# Procedure for Financing a Project with Revenue Bonds Issued by the Director of the Nevada Department of Business and Industry

- Nevada law defines the types of “projects” that can be financed. NRS 349.510
- The Internal Revenue Code defines whether the interest paid to the holder of such bonds is exempted from being included in the taxable income of the holder.
- The Director gathers the information needed to determine if the office can finance a proposed project and whether bonds issued for such purpose will be tax-exempt from discussions with the project sponsor and from the written application submitted by the project sponsor.

# The Written Application with Required Enclosures is Submitted – Now What?

- The Director circulates copies to the Director's legal and financial experts for review.
  - A project that appears to be eligible for financing may require the submission of additional clarifying information.
  - Within 30 days following receipt of a complete application, the Director will either accept the application or notify the applicant as to the reasons why the application in its current form is not acceptable.
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# The Application is Accepted – Now What?

- The Director sends to the sponsor a written confirmation of the Director's intention to issue bonds to finance the project up to a stated amount and subject to the state and federal law requirements outlined in the letter.
- The project sponsor makes a deposit with the Director, which will be used to pay for the Director's costs to process the transaction and obtain the required state and local government approvals.

# More Approvals?

- Yes. The federal tax code requires that a public hearing be held after giving reasonable public notice, at which the public may comment on the proposed financing. A report of that hearing must be made to the Governor, and the Governor must approve the transaction after reviewing that report.
- Nevada state law requires that the Director make written findings concerning the public benefits of the transaction and that those findings be submitted to and approved by the Nevada State Board of Finance and by the governing body of the local government where the project is to be located. In addition, the Nevada Office of Economic Development must determine that the proposed project is consistent with the State Plan for Economic Development.



# Show Me The Money!

- While the public hearing, the State Board of Finance meeting and the local government meetings were all moving forward the Director and the sponsor were working with the team of legal and financial advisors, the bond under-writer purchaser and their legal team to structure the financing on the best possible terms.
- The sponsor receives bond proceeds in the amount necessary to build and equip a successful project that makes lots of money for the sponsor, increases the tax base for the State of Nevada, and provides employment for qualified workers.

# Financial Analysis

## Presenter

Kathy Ong

Partner

Hobbs, Ong  
& Associates,  
Inc.

# Role of the Financial Advisor

- Act in a fiduciary capacity for the Department
- Assist Department with initial evaluation of application
- Assist in developing plan of finance and related transaction timetable
- Coordinate financing and debt issuance process
- Evaluate underwriter proposals
  - Provide financial analysis and recommendations
  - Evaluate different debt options
  - Assist in assessment of risks, costs and benefits
- Assist in assembly of finance team
- Procurement of professional services
  - Trustee
  - Printer
  - Underwriters

# Applicant Information Requirements

- Copy of Business Plan
- Copy of 5-year operating history from “obligor” guaranteeing the payment of bonds (NRS 349.590)
  - History is not required if bonds are to be sold to qualified institutional buyers; **OR**
  - Will receive rating within one of top four rating categories of Moody’s, S&P and Fitch
  - The Obligor could be the Company (if rated by one of the rating agencies noted above) or it could be a bank providing a letter of credit guaranteeing interest and principal payments on the bonds if the Company does not pay the principal and interest.
- Identify purchaser of bonds and how bonds will be sold (publicly offered or privately placed and under what terms)

# Rating Categories

S&P/FITCH	MOODY's	Meaning
AAA	Aaa	Bonds of the best quality, offering the smallest degree of investment risk.
AA+	Aa1	Bonds of high quality by all standards. Slightly higher degree of long-term investment risk.
AA	Aa2	
AA-	Aa3	
A+	A1	Bonds with many favorable attributes.
A	A2	
A-	A3	
BBB+	Baa1	Bonds of medium-grade quality. Security appears adequate at present but may appear unreliable over the long term.
BBB	Baa2	
BBB-	Baa3	
BB+	Ba1	Bonds with speculative element. Moderate security of payments; not well safeguarded.
BB	Ba2	
BB-	Ba3	

# Past Transactions – Panel Discussion

## Presenters

Ryan Warburton == Ballard Spahr LLP

John Wang == Orrick, Herrington & Sutcliffe LLP

Richard Jost == Fennemore Craig Jones Vargas

# Past Transactions



Las Vegas Monorail –  
Public Transit/Nonprofit

Republic Services –  
Solid Waste  
Disposal/Profit



# Past Transactions



SME Industries, Inc –  
Manufacturing

Carson Tahoe Hospital –  
Health Care Facility





# Past Transactions



Chelten House Products –  
Manufacturing

# Do's and Don'ts– Panel Discussion

## Presenters

Ryan Warburton — Ballard Spahr LLP

John Wang — Orrick, Herrington & Sutcliffe LLP

Richard Jost — Fennemore Craig Jones Vargas

# Questions & Answers

